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SUBJECT: BOSNIA: EBRD ATTEMPTS TO REVIVE THE 5C CORRIDOR HIGHWAY

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¶1. SUMMARY: The European Bank for Reconstruction and Development (EBRD) has devised a plan to kick start the Corridor 5C highway project in the Federation. Although traditional EBRD loans coordinate primarily with state officials and require sovereign backing and guarantees to repay the loan, EBRD is focusing first on the Federation. Four new sections of the highway, totaling 67 kilometers, will all run through Federation territory. Because of the necessity for a state guarantee, EBRD mandated that a 10-pfennig/liter gas tax be levied by the State-level government's Indirect Taxation Authority. However, only the Federation will use its portion, estimated at 100 million KM/annually, to pay back the EBRD loan and to provide maintenance. The RS will be allowed to use its proceeds for other motorway infrastructure projects. Although EBRD's strategy supports RS motives to work independently from the Federation, it was likely the only way to get the highway project started, and ensure the necessary RS approval for the state-level funding. END SUMMARY

¶2. Recently, Econoffs met with several Federation officials, EBRD officials and the head of local engineering and consulting firm, IPSA, for an update on the Corridor 5C project, a portion of the European plan to upgrade transportation networks through Southeastern Europe (reftel).

The meetings were in conjunction with the visit of Bechtel's Senior Vice President Charles Redmond (former U.S. Ambassador to Germany) to Sarajevo to see if there are any realistic opportunities for Bechtel in the 5C project. (Note. Bechtel noted at the meetings it is not interested in smaller scale, segmented projects and will likely not bid unless 5C is funded and offered as a single project. End note.) The section designated on European Union projected highway maps as 5C runs from Budapest, Hungary, to the Adriatic port of Ploce in Croatia. The Bosnian portion of the highway runs from Svilaj (on the border with Croatia) through Zenica, Sarajevo, Mostar, and south to the Croatian border opposite Ploce. The route is approximately 335km long. The project has floundered for years because of RS Premier Dodik's refusal to take part in a State-level project or to agree to State-level comprehensive legislation on highways. Compounding the problem is the inability of Bosnian officials to gain serious interest from possible foreign investors for a concession to build the entire project.

EBRD PLANS FOR 5C CORRIDOR CONSTRUCTION

¶3. Despite prior IMF opposition to Bosnia accepting additional debt to finance road construction (reftel), on October 28, Bosnian State authorities signed a contract with EBRD worth 180 million Euros to finance a portion of the 5C corridor. These funds, in addition to 300 million Euros from the European Investment Bank (EIB), (negotiations are

underway) will fund four segments of the 5C corridor totaling 67 kilometers. EBRD is also projecting a 125 million Euro contribution from the Federation Motorway Directorate for a total of approximately 605 million Euros to complete the four sections. Plans are to have these segments completed by 2012. This would comprise 20 percent of the total 5C corridor. EBRD hopes to have construction started by the summer of 2009 on at least one 15.9 kilometer segment between Kakanj and Zenica.

¶4. EBRD officials explained that their strategy is to move toward a concession in stages. First, (nearly completed as noted below) was the 30 kilometers from Sarajevo to Kakanj funded directly from the Federation budget. The new plan for four additional segments will be funded by the EBRD and EIB but backed by sovereign guarantee. The EBRD hopes that the completion of the four segments and the ensuing toll revenue will finally attract a concession investor. The EBRD has also not given up on eventual participation from the RS for the roughly 60 kilometers of the project that will go through the RS. One EBRD official noted that the often-announced RS two billion Euro deal with Austrian construction firm Strabag will likely fail because the current financial troubles of Strabag's 30% owner Russian oligarch Oleg Deripaska will prevent Strabag from living up to its investment promises.

PAYING OFF THE EBRD LOAN?

¶5. Although technically a country must provide state guarantees for repayment of EBRD loans, it appears that this recent EBRD loan will actually be repaid by the Federation.

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Evidence of this is the point of contact for the loan, the Federation Minister of Transport's Motorway Directorate. Part of the agreement with the EBRD was to have a 10 pfennig/liter (equivalent to 5 Euro cents) gas excise tax to help finance repayment of the loan. The EBRD is somewhat vague on what State-level legislation will be needed, but passing a gas excise tax will require the RS and Federation politicians in the State Parliament to consent to passage. Although we heard varying estimates, the gas tax should collect approximately 40 million Euros for motorway construction in the Federation alone. The tax must go towards motorway construction, but the RS will not be expected to use its proceeds to pay back the EBRD loan, as the financed portions will not run through the RS.

FEDERATION-FINANCED PORTION NEARING COMPLETION AFTER TWO YEARS

¶6. Construction of 37 km of road from Sarajevo north to Kakanj is nearing completion after almost two years under construction. The Federation financed this portion directly from its budget, explained the Minister of Transport, Seckanovic, as they saw this as the easiest portion without tunnels. The cost will total 200 million KM or approximately 100 million Euros once it is complete; 60 million KM will come out of this year's budget. According to IPSA President Esref Gacanin, four local companies with previous road building experience won the tender to build this section of the road. Revenue from the existing toll road, however, also goes directly into the Federation budget and is worth approximately 12 million KM annually. When the Kakanj section is complete, the Federation plans to raise the toll rates and will draw double the amount of revenue. According to Seckanovic, 50 percent of the revenue will go towards new roads and the remainder toward maintenance of existing roads.

OTHER PLANS GET SHORT SHRIFT WITH BOSNIAN OFFICIALS

¶7. Ambassador Redmond reminded the Bosnian officials of

Bechtel,s previous attempts to work with the country to find financing for the entire highway, versus working piecemeal. He used the example of Albania, which used 800 billion Euros of sovereign financing and made their highways a top priority of the central budget. They completed many miles of highways in the shortest amount of time when using their own financing and internationally-recognized infrastructure companies. Bechtel finished 60 kilometers of road in Albania, for example, while the World Bank-financed portion of 9 kilometers is still pending.

OTHER PLAYERS IN THE 5C GAME

¶18. In a separate move, the Federation also issued a statement of interest in April 2008 for construction of the Mostar-Sarajevo portion in a public-private partnership (PPP). The 67 km portion of tolled highway, from Sarajevo to Zenica that is already partly complete would be used by the Government as collateral for the project. The contractor would be given access to toll revenues on the existing highway for a defined amount of time. According to Seckanovic, 11 international companies expressed interest. However, according to Federation Minister of Finance Bevanda, many Federation politicians still do not favor PPP,s, so this attempt will likely not bear fruit.

¶19. Federation Minister of Transportation Seckanovic also noted ongoing discussions with the Japanese investment agency JBIC to finance some of the more difficult portions of the road, including the new tunnels. JBIC has offered them a less than 1 percent interest loan for a term of 30-40 years, with the obligation that they use Japanese construction firms. He said they are still in discussions with them.

COMMENT

¶10. Hopefully the energetic attitude of EBRD officials to get the 5C Corridor project moving will have some positive results. There is still a chance that negotiations with the EIB for the additional 300 million Euros will fall through. In that case, the Federation may not have enough funds to complete the four small sections. It is difficult if not impossible to foresee a scenario, however, where a country-wide highway infrastructure strategy will be implemented by present-day BiH officials in this fractured political landscape. It can be argued that the EBRD,s strategy to at least get some momentum on the project by

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working with the Federation vindicates the RS refusal to join in a country-wide approach. EBRD,s move, however was likely the only way to move forward. Nonetheless, if the RS-Strabag agreement fails, even the RS may be persuaded to join the project. In any event, construction of the four additional highway segments could turn out to be an important economic stimulus for the Bosnian economy.

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